UKRAINE

TRADE SUMMARY

The U.S. trade deficit in 1999 with Ukraine was $314 million, an increase of $150 million from 1998. U.S. exports to Ukraine were $204 million, a sharp decrease from the $367 million exported in 1998. Ukraine was the United States' 87th largest export market in 1999. U.S. imports from Ukraine were $518 billion in 1999, a decrease of $13 million (2.4 percent) from 1998. The stock of U.S. foreign direct investment in 1998 was $92 million, a 667 percent increase from 1997. According to the information from the Ukrainian Government and the private sector, the United States was the largest foreign investor in Ukraine as of October 1999, accounting for $570 million (or 18 percent) of total foreign direct investment. The major foreign investments in Ukraine were in telecommunications, tobacco, soft drinks, food processing, consumer goods, detergents, electric power, oil and gas, agribusiness and fast food. As of December 1999, there were more than 300 U.S. companies operating in Ukraine.

Trade relations between the United States and Ukraine are governed by the 1992 U.S.-Ukraine Trade Agreement. In this agreement, both countries grant each other most-favored-nation (MFN) status. The United States has not granted Ukraine permanent MFN status, however, Ukraine does fully comply with the Jackson-Vanik requirements. Ukraine is not a member of the World Trade Organization (WTO), but it has applied to join.

IMPORT POLICIES

The generally high import duties and taxes in Ukraine present a major obstacle to trade. For example, import duties range from 5 to 200 percent, excise taxes range from 10 to 300 percent, and the value added tax (VAT) is 20 percent. Ukraine has very high tariffs on a number of products entering the Ukrainian market; Ukraine's current tariff rates equate to an *ad valorem* equivalent of 150-300 percent on most U.S. distilled spirits exports to Ukraine. In general, Ukraine has two kinds of tariff rates – general (or full-rate) tariffs, and preferential (or partial-rate) tariffs. Preferential tariff rates vary according to the type of products imported. Imports from western countries are generally assessed preferential tariffs. Import duties largely depend on whether a similar item to that being imported is produced in Ukraine; if so, the rate may be higher.

On January 1, 2000, border checkpoints began collecting a new uniform customs duty, combining seven import fees – customs clearance, sanitary, veterinarian, phytosanitary, radiation, ecological control, as well as fees charged for the passage of vehicles on the motor roads of Ukraine – into a single tax. If properly implemented, this could considerably ease the customs clearance process.

As of January 1, 2000, the list of excisable goods will be reduced from 20 to five: alcohol, tobacco, oil products, automobiles, and jewelry. Excise duty rates are expressed as a percentage of the declared customs value, plus customs duties and fees paid for importing products. The excise tax for jewelry, in particular, will increase to 55 percent (up from the previous 35 percent). In October 1999, the duty on textile goods was reduced to 5-10 percent; earlier importers had to pay a 30 percent duty.

In general, U.S. exports to Ukraine receive preferential customs rates if the following three criteria are met: (1) the company is registered in the United States; (2) the goods have a certificate to prove U.S. origin; and (3) the goods are imported directly from the United States. There are no special registration or other requirements, according to the State Customs Committee.

Duties on goods imported for resale are subject to varying *ad valorem* rates. Imported goods are not considered legal imports until they have been processed through the port of entry and cleared by Ukrainian customs officials. Import licenses are required for few goods, primarily medicines, pesticides, and some industrial chemical products.

Ukraine's liquor tax system discriminates against imported products and provides protection for domestic producers. For example, under this system, all imported distilled spirits are taxed at a rate of three Euro per liter. However, brandy produced domestically is taxed at a rate of 0.25 Euro per liter. This preferential treatment is due to be eliminated by 2000.

A limited number of goods, including raw materials, component parts, equipment, machinery, and energy supplies imported by commercial enterprises for "production purposes and their own needs" are exempted from the VAT. Many agricultural enterprises are also exempt from paying VAT.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Ukraine's regulatory environment is chaotic, and foreign investors still regard Ukraine's production certification system and licensing procedures as one of the most serious obstacles to trade, investment, and ongoing business. Although Ukraine recently lowered the overall number of licenses from 112 to 42 – making the certification process somewhat less difficult to navigate – many consider this lower number to be excessive.

U.S. businesses identify the standards and certification problems affecting the consumer goods industry as: (1) lack of constant, clearly defined standards and regulations; (2) registration schemes unfeasible for mass trade; (3) lack of procedural flexibility; (4) complex and lengthy import license procedures; 5) overly complex and expensive certification requirements; (6) uneven enforcement of requirements; and (7) high certification and licensing fees. These bureaucratic procedures and problems significantly raise the cost of doing business in Ukraine, provide opportunities for corruption, and drive much activity into the burgeoning shadow economy. While the law may stipulate formal equality of treatment of both national and foreign companies, U.S. businesses are left with a very strong impression that the laws are not applied equally and that, in fact, there is a discrimination against foreign companies. As a result, such requirements are a major hindrance to potential investment in Ukraine.

Ukraine applies a range of sanitary and phytosanitary measures that are not consistent with a science-based approach to regulation. The certification and approval process is often lengthy, duplicative, and expensive.

The numerous certification bodies around Ukraine effectively operate as independent (often monopolistic) entities on a private profit basis, returning only 20 percent of the proceeds derived from certification fees to the state. The state standards committee does not properly supervise or enforce the vague pricing rules. Consequently, the agencies do much of the legislative and interpretive work with little or no coordination. In addition, many products require multiple certificates from multiple agencies, with local, regional and municipal authorities often requesting additional documentation beyond that required by central agencies.

There is a new push to certify all food additive ingredients, especially for certain products such as chocolate and carbonated beverages, for which all ingredients must be certified. Some companies report having to pay $20,000 to buy the equipment used to test ingredients in use for more than 100 years (in some cases) in order to certify that they are safe for consumption. This is especially true for pre-packaged goods. In 1998, Ukraine introduced a requirement for certificates of conformity in order to import distilled spirits. To obtain such certificates a firm at its expense must have Ukrainian officials conduct exhaustive inspections of the producer's facilities. This expensive and onerous requirement has caused several U.S. distilled spirits exporters to withdraw their products from the Ukrainian market.

The U.S. telecommunications industry association reports that the certification and licensing procedures for telecommunications equipment are numerous and particularly burdensome, which is impeding access to the Ukrainian market.

GOVERNMENT PROCUREMENT

Ukraine still has no central public procurement law with uniform standards, although it has a draft law on government procurement under consideration. Regulations are the responsibilities of individual ministries, and are often not followed in practice. Among the problems faced by foreign firms are (1) a lack of public notice of tender rules, (2) the failure to state tender requirements, (3) covert preferences in tender awards, (4) awards made subject to conditions that were not part of the original tender, and (5) the lack of an effective avenue for firms to air grievances over contract awards or an effective means to resolve disputes. Ukraine is not a signatory of the WTO Agreement on Government Procurement.

EXPORT SUBSIDIES

There is no reliable estimate of the nature and amount of export subsidies, particularly as they relate to Ukraine's export of steel products to the United States. It is known that many Ukrainian enterprises do not pay taxes, do not pay for energy usage, clear transactions by offsetting mutual debts, and receive free or below-cost government inputs.

INTELLECTUAL PROPERTY RIGHTS PROTECTION

A serious and growing piracy problem, particularly with regard to optical media (CDs and CD-ROMs), undermines Ukraine's efforts to protect intellectual property rights (IPR). Still, Ukraine has made progress in developing a comprehensive legislative system for the protection of IPR. As a successor state to the former Soviet Union, Ukraine is a member of the Universal Copyright Convention (May 1973), and the convention establishing WIPO, the World Intellectual Property Organization (April 1970). After independence, Ukraine became a signatory to a number of key agreements, including: the Paris Convention for the Protection of Industrial Property (1991); the Madrid Agreement Concerning the International Registration of Marks (1991); the Patent Cooperation Treaty (1991); the Agreement on the Measures Related to the Protection of Industrial Property and the Establishment of the Interstate Council for the Protection of Industrial Property in the Commonwealth of Independent States (1993); the International Convention for the Protection of New Varieties of Plants (1995); the Berne Convention for the Protection of Literary and Artistic Works (1995); the Trademark Law Treaty (1996); the Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purpose of Patent Procedures (1997). In addition, Ukraine has laws on the Protection of Rights in Inventions and Utility Models (1993, the Protection of Rights in Industrial Designs (1993), the Protection of Rights in Marks for Goods and Services (1993), and the Protection of Plant Variety Rights (1993). As part of its Bilateral Investment Treaty with the United States, which went into effect in 1996, Ukraine committed itself to protect copyrights in U.S. works.

In 1999, Ukraine took an important step to improve its copyright and neighboring rights regime by becoming a signatory to the Geneva

Phonograms Convention. Four additional bills that would amend or expand existing IPR legislation were submitted to parliament in June 1999. One bill would amend the copyright law by clarifying the scope of computer programs, audio-visual products, etc. It also would expand on the collective representation of copyright owners concerning the collection of royalties. The other bills would amend the laws for utility models and trademarks, and introduce protection for geographical indications.

Against this backdrop of enacting critical IPR legislation and becoming a signatory to key conventions, a serious problem of copyright piracy has emerged in Ukraine. Consequently, Ukraine was placed on the Special 301 Watch List in 1998 and was elevated to the Priority Watch List in 1999. Pirates have set up optical media (CDs and CD-ROMs) production facilities in Ukraine and are exporting a large volume of unauthorized copies throughout Europe. The U.S. music industry estimates that it alone lost an estimated $210 million in revenues for 1999. The Motion Picture Association calculates that it lost $40 million in revenues in 1999 from audio-visual piracy, including due to the unauthorized broadcast of U.S. audio-visual products by television and cable companies. Ukraine acknowledges the serious problem with piracy and is seeking help from the United States to combat it.

Ukrainian legislation has inadequate criminal penalties for copyright piracy. It does not provide customs procedures for copyright infringement, leaving the border open for the import and export of pirated goods. With the exception of an occasional crackdown, cleaning the streets of pirate vendors, or checking licenses, enforcement is negligible. Courts do not provide a reliable means to address copyright infringement: first, because there are too few judges trained in intellectual property law; and second, because legal reform has not advanced far enough for enterprises to have confidence in seeking a court settlement.

Administrative liability, in the form of fines and/or confiscation of products, equipment, and raw materials, may be sought in the event that an infringement of intellectual property rights is accompanied by unfair competition on the part of the infringer. However, fines are insignificant, and the law does not give the police or customs the authority to conduct seizure or ex-parte searches. Ukraine is attempting to remedy these shortcomings, but it admits this will take a long time.

Ukraine is in the process of acceding to the WTO, and it has set for itself the goal of bringing its laws into compliance with the requirements of the WTO TRIPS Agreement. The United States firmly insists that Ukraine's IPR regime be TRIPS-compliant at the time of accession, with no transition period. Ukraine has established a working group on intellectual property with the United States.

With respect to trademarks, counterfeiting of western products in Ukraine has increased dramatically after the Fall 1998 financial crisis, with industry sources estimating that, overall, fifty percent of the name brand products on the Ukrainian market may be fake. While it is illegal to sell counterfeit products in Ukraine, the law permits companies to produce counterfeit packaging legally, with the result that many legally licensed factories, including state-owned factories, also produce counterfeit products. Unfortunately, the government of Ukraine has done little to address this problem. When action is taken, it is usually by the companies, mostly foreign, that are affected.

SERVICES BARRIERS

Ukraine has few explicit services restrictions, so professionals (lawyers, accountants, etc.) are able to work in Ukraine, but in practice the lack of transparency and the multiplicity of licensing authorities hinder access to the Ukrainian market. Since Ukraine is interested in becoming a member of the European Union (EU), it is considering establishing a quota on foreign films, following the EU example. There already is a local content provision for radio and television broadcasting, but it has not been stringently enforced.

INVESTMENT BARRIERS

An underdeveloped banking system, poor communications networks, a difficult tax and regulatory climate, increasing occurrences of crime and corruption, limited opportunities to participate in privatization, the absence of clear mechanisms to enforce intellectual property rights (thus creating a barrier to technology transfer to Ukraine), poorly defined and overly complex certification procedures, and a poorly-functioning and unstable legal system combine to create major obstacles to U.S. investment in Ukraine. In addition, the government canceled previous privileges adopted for foreign investors (i.e., exemption from customs duties and the value added tax (VAT) on imported products, and a five-year tax holiday), which further discouraged investors.

Ukraine’s burdensome and frequently changing tax structure remains a major hindrance to foreign investment and business development. Personal income taxes remain high, although pending tax code legislation includes provisions to lower the rates. Combined payroll taxes (mainly for pensions) have been reduced from the previous high of 52 percent to 37.5 percent – still high, but a considerable improvement. Modern VAT and corporate income tax laws have been enacted and implemented, with provisions for normal business deductions, VAT credits, etc. However, numerous amendments and exemptions have created a confusing and possibly inequitable situation. There are frequent changes in other tax laws and regulations as well, such as import duties and excise taxes, often with little advance notice, giving foreign companies little time to adjust to new requirements. Improvements are being made in tax filing and collection procedures, although they still differ from those in western countries in significant ways. Recognizing that this can cause frictions, the Chairman of the State Tax Administration has established an advisory committee on the tax problems of foreign companies that has been functioning for about a year and has already achieved mutually favorable resolutions of some difficult issues brought to it by U.S. and other foreign companies.

In the estimation of many U.S. businesses in Ukraine, Cabinet of Ministers’ Resolution 2028 of November 1, 1999, concerning work visas for foreigners may create additional burdens for foreign enterprises. The resolution changes tax requirements and increases the personal income tax for foreign workers, who will also be required to pay into Ukraine’s unemployment fund. In addition, the work visa requirements will become more stringent, with more documentation necessary in order to obtain a work visa. This would include the requirement to show an employment contract and a tax certification showing that the foreign worker has paid all taxes at the time of application. In the past, foreign enterprise representative offices were allowed one director who did not need a work visa. Foreign journalists were also exempted.

The United States has a Bilateral Investment Treaty (BIT) with Ukraine, which took effect on November 16, 1996. The BIT guarantees for U.S. investors the better of national and MFN treatment, the right to make financial transfers freely and without delay, international law standards for expropriation and compensation, and access to international arbitration. However, U.S. investors face numerous everyday “doing business” problems and regard the BIT as a tool of last resort.

A council of independent experts, established by the president, has arbitrated in a number of investment disputes. Its rulings are not legally binding, but its decisions have generally been upheld. It is not a formal dispute mechanism, but the Ukranian Government would like to elevate it to such.

To attract investments and remove obstacles to trade, Ukraine created five free economic zones (FEZ) in 1997-1998 that would have a favorable regime for investors: Donetsk, Mariupol, Slavutych, Yavoriv, and Transcarpathia. Special investment zones have also been introduced in other cities and regions, although they do not have the same favorable investment conditions, such as independent customs borders, that the economic zones do. In 1999, Ukraine did not create new economic zones, as part of an IMF loan condition that it not grant additional tax breaks.

ELECTRONIC COMMERCE

Currently, the Internet and electronic commerce are still in their infancies in Ukraine. To date, the Ukrainian Government has not sought to regulate or provide specific protections for this sector.